

36. On page 46529, column 1, § 1.954-2 (h)(4)(iv), Example 5, line 3, the language "receivable to Y for \$99 on day 45, at which" is corrected to read "receivables to Y for \$99 on Day 45, at which".

37. On page 46529, column 1, § 1.954-2 (h)(4)(iv), Example 5, lines 7 through 10, the language "receivable at a rate equal to at least 120 percent of the applicable Federal short-term rate, income derived by Y from the factored receivable is excluded from factoring income" is corrected to read "receivables at a rate equal to at least 120 percent of the applicable Federal short-term rate, income derived by Y from the factored receivables is excluded from factoring income".

38. On page 46529, column 1, § 1.954-2 (h)(4)(iv), Example 6, line 4, the language "controlled foreign corporation. On Day 1" is corrected to read "controlled foreign corporation. On Day 1,".

39. On page 46529, column 2, § 1.954-2 (h)(6), Example 1, is corrected to read as follows:

**§ 1.954-2 Foreign personal holding company income.**

\* \* \* \* \*

(h) \* \* \*

(6) \* \* \*

Example 1. *CFC*, a controlled foreign corporation, promises that Corporation A may borrow up to \$500 in principal for one year beginning at any time during the next three months at an interest rate of 10 percent. In exchange, Corporation A pays *CFC* a commitment fee of \$2. Pursuant to this agreement, *CFC* lends \$80 to Corporation A. As a result, the entire \$2 fee is included in the computation of *CFC*'s foreign personal holding company income under paragraph (h)(2)(i)(G) of this section.

\* \* \* \* \*

40. On page 46529, column 2, § 1.954-2 (h)(6), paragraph (i) of Example 3, lines 7 and 8, the language "a floating rate of interest set at the London Interbank Offered Rate (LIBOR) plus one" is corrected to read "a floating rate of interest set at LIBOR plus one".

41. On page 46529, column 3, § 1.954-2 (h)(6), paragraph (i) of Example 4, line 1 in the column, the language "contemporaneously, enters into a 3 month" is corrected to read "contemporaneously, enter into a 3-month".

**§ 1.957-1 [Corrected]**

42. On page 46529, column 3, § 1.957-1 (a)(2), the third line from the bottom of the paragraph, the language "association, joint stock company, or" is

corrected to read "association, joint stock company or".

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**26 CFR Part 1**

[TD 8629]

RIN 1545-AL57

**Certain Publicly Traded Partnerships Treated as Corporations**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations relating to the classification of certain publicly traded partnerships as corporations. These regulations provide guidance needed by taxpayers to comply with changes to the law made by the Omnibus Budget Reconciliation Act of 1987. The regulations affect the classification of certain partnerships for federal tax purposes.

**DATES:** These regulations are effective December 4, 1995.

For dates of applicability of these regulations, see § 1.7704-1(l).

**FOR FURTHER INFORMATION CONTACT:** Christopher T. Kelley, (202) 622-3080 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**Introduction**

This document adds § 1.7704-1 to the Income Tax Regulations (26 CFR part 1) relating to the definition of a publicly traded partnership under section 7704(b) of the Internal Revenue Code (Code).

**Background**

Section 7704 was added to the Code by section 10211(a) of the Omnibus Budget Reconciliation Act of 1987 (Public Law 100-203), as amended by sections 2004(f)(1)-(5) of the Technical and Miscellaneous Revenue Act of 1988 (Public Law 100-647). Section 7704(a) provides that a publicly traded partnership is treated as a corporation for federal tax purposes unless the partnership meets the 90 percent qualifying income test of section 7704(c) or qualifies as an existing partnership. The term *existing partnership* is defined in § 1.7704-2. Under section 7704(b), a partnership is a publicly traded partnership if interests in the partnership are traded on an established securities market or are readily tradable

on a secondary market or the substantial equivalent thereof. Section 7704 applies to all domestic and foreign entities treated as partnerships under section 7701, including limited liability companies and other entities treated as partnerships for federal tax purposes.

Notice 88-75 (1988-2 C.B. 386) was issued to provide interim guidance on the definition of a publicly traded partnership under section 7704(b). Notice 88-75 provides that interests in a partnership are not treated as readily tradable on a secondary market or the substantial equivalent thereof for purposes of section 7704(b)(2) if the interests are: (1) Issued in certain private placements; (2) transferred pursuant to transfers not involving trading; (3) traded in amounts that meet the requirements of a 5-percent or 2-percent safe harbor; (4) transferred through a matching service that meets certain requirements; or (5) transferred pursuant to a qualifying redemption or repurchase agreement. Notice 88-75 does not address when partnership interests are treated as traded on an established securities market for purposes of section 7704(b)(1).

On May 2, 1995, the IRS published in the Federal Register a notice of proposed rulemaking (60 FR 21475) to provide guidance regarding section 7704(b). A number of public comments were received concerning the proposed regulations, and a public hearing was held on July 31, 1995. After consideration of the comments received, the proposed regulations are adopted as revised by this Treasury decision.

**Summary of Significant Comments and Revisions**

The significant comments on the proposed regulations and the revisions made in the final regulations are discussed below.

**Public Trading**

Several commentators requested clarification of the definition of an established securities market, a secondary market, and the substantial equivalent of a secondary market. The definitions in the proposed regulations, however, are drawn directly from the legislative history to section 7704(b) and incorporate the most important elements of public trading within the meaning of section 7704(b). As a result, the final regulations generally adopt the definitions in the proposed regulations.

The final regulations contain two changes to the definition of a secondary market and the substantial equivalent thereof. The final regulations clarify that the determination of whether interests in a partnership are readily tradable on

a secondary market or the substantial equivalent thereof is based on all the facts and circumstances. In addition, the final regulations eliminate the separate definitions of a secondary market and the substantial equivalent thereof. This distinction is relevant in the proposed regulations because several of the safe harbors apply only to the substantial equivalent of a secondary market. As discussed below, this distinction is eliminated in the safe harbors. As a result, the separate definitions of a secondary market and the substantial equivalent thereof are no longer necessary, and they are combined into one definition in the final regulations.

The proposed regulations provide that the transfer of an interest in a partnership is taken into account for purposes of section 7704(b) only if the partnership recognizes the transfer of the interest or the interest is redeemed by the partnership. The preamble to the proposed regulations explains that this provision is intended to prevent a partnership from becoming publicly traded without the knowledge or participation of the partnership. Several commentators requested a clarification of this provision because the definition of a secondary market requires only that the interests be readily tradable, thereby creating some concern that the partnership could be publicly traded even if there were no actual transfer of an interest in the partnership.

The final regulations address this concern by providing more explicitly that interests in a partnership will not be treated as readily tradable on a secondary market or the substantial equivalent thereof unless (i) the partnership participates in the establishment of the market or the inclusion of its interests thereon, or (ii) the partnership recognizes transfers made on that market. This rule also applies to an established securities market that consists of an interdealer quotation system that regularly disseminates firm buy or sell quotations. These modifications will prevent a partnership from being publicly traded without the participation or consent of the partnership. This rule is not extended to established securities markets that consist of the exchanges described in the regulation because these exchanges list interests in the partnership only with the knowledge and participation of the partnership. In addition, the final regulations provide that transfers not recognized by the partnership are treated as private transfers and therefore do not count for purposes of the two-percent and 10-percent limitations in the safe harbors described below.

#### Safe Harbors

Several commentators requested clarification that, as in Notice 88-75, the failure of a partnership to satisfy the safe harbors does not establish or give rise to a presumption that the partnership was publicly traded. In response, the final regulations clarify that the fact that a partnership does not qualify for a safe harbor or that a transfer of an interest in the partnership is not within a safe harbor is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof. Thus, these transfers are examined under the general facts and circumstances test in the regulations.

#### Private Transfers

Several commentators requested that the definition of a block transfer be expanded to include transfers by a partner or any person related to the partner within the meaning of section 267(b) or section 707(b)(1). The commentators noted that interests in a partnership are often held by related persons and that, while the related group as a whole may hold more than a two-percent interest in the partnership, no individual partner in the group might hold more than a two-percent interest. This comment is adopted in the final regulations.

One commentator also suggested that the exception for transfers at death be clarified to include transfers from an estate or a testamentary trust. This comment is adopted in the final regulations.

Another commentator suggested that the exception for transfers by one or more partners of interests representing more than 50 percent of the total interests be expanded to include transfers of less than 50 percent. This comment is not adopted in the final regulations. The exception is provided to allow acquisition of control of a partnership without raising a concern that the transfers pursuant to the acquisition would result in the partnership being publicly traded. The exception is, however, amended by reducing the required amount to 50 percent or more of the interests in partnership capital and profits to coordinate the exception with section 708(b)(1)(B) terminations.

#### Redemption and Repurchase Agreements

Several commentators suggested that redemptions by an investment partnership for the net asset value of the redeemed interest should not be treated

as a transfer for purposes of section 7704(b) because these transfers do not involve a third party broker or a commission or mark-up. This comment is not adopted in the final regulations. The redemption of a partnership interest combined with the issuance of an interest to a new partner can result in the creation of a secondary market or the substantial equivalent thereof within the meaning of section 7704(b), even if no third party or commission is present.

#### Qualified Matching Service

The proposed regulations provide that, to qualify as a matching service, the selling partner cannot enter into a binding agreement to sell an interest until the 15th calendar day after the date information regarding the offering is made available to potential buyers and the closing cannot occur until the 30th calendar day after the date the selling partner can enter into a binding agreement. One commentator suggested a reduction in these fixed time periods. This comment is not adopted in the final regulations. The time periods are necessary to ensure that the matching service does not rise to the level of a secondary market or the substantial equivalent thereof.

Several commentators raised various concerns about the provisions in the proposed regulations requiring subscribers to make certain representations and the provisions preventing the operator of the matching service from quoting certain prices and buying or selling interests for itself or on behalf of others. These provisions are deleted in the final regulations because the requirements for a matching service already provide that the service cannot list quotes that commit any person to buy or sell an interest. This modification, however, does not affect the general rule that a secondary market may exist if anyone, including the operator of a matching service, quotes prices at which it stands ready to buy or sell partnership interests.

#### Private Placements

The proposed regulations generally provide that interests in a partnership are not readily tradable on the substantial equivalent of a secondary market if (i) all interests in the partnership were issued in a transaction not required to be registered under the Securities Act of 1933; (ii) the partnership does not have more than 500 partners or the initial offering price of each unit was at least \$20,000; and (iii) if the partnership has more than 50 partners, no more than 10 percent of the total interests in capital or profits are transferred during the year. Several

commentators suggested expanding this safe harbor to apply to the determination of a secondary market. Other commentators suggested eliminating the 10-percent limitation. Several commentators suggested increasing the 50-partner limit, such as to 100, and modifying the rule for counting the number of partners that looked through partners that were partnerships, grantor trusts, or S corporations. In response to these comments, the final regulations modify the private placement exception in the following respects.

First, the safe harbor is expanded to apply to a secondary market as well as the substantial equivalent of a secondary market. As a result, interests in a partnership that qualifies for the private placement safe harbor will not be readily tradable on a secondary market or the substantial equivalent thereof.

Second, the final regulations provide that the safe harbor does not apply to partnerships subject to Regulation S (17 CFR 230.901 et seq.), unless the offering and sale of interests in the partnership would not have been required to be registered if offered and sold within the United States. Regulation S, adopted after the issuance of Notice 88-75, provides an exception from registration for any offerings and sales outside of the United States, even if registration would have been required if the interests were offered and sold within the United States. This modification ensures that the private placement exception applies in a similar manner to offerings within and outside of the United States.

Third, the 10-percent limitation is not adopted in the final regulations. Instead, the final regulations provide that the safe harbor applies only if the partnership has no more than 100 partners at any time during the taxable year of the partnership.

Finally, the final regulations provide a new rule for determining the number of partners in a partnership. Under the proposed regulations, each person owning an interest in a partnership (lower-tier partnership) through another partnership, an S corporation, or a grantor trust (flow-through entity) is treated as a partner in the lower-tier partnership. The final regulations provide that an owner of a flow-through entity is treated as a partner in the lower-tier partnership only if (i) substantially all of the value of the flow-through entity is attributable to the lower-tier partnership interest, and (ii) a principal purpose for the tiered arrangement is to permit the partnership to satisfy the 100-partner requirement.

The requirement that substantially all of the value of the flow-through entity be attributable to the lower-tier partnership is intended to limit the look-through rule to flow-through entities that are economically equivalent to an interest in the lower-tier partnership. For example, if the only asset held by a flow-through entity is an interest in a lower-tier partnership, an interest in the flow-through entity is economically equivalent to an interest in the lower-tier partnership and the members of the flow-through entity should be counted as partners in the partnership. The requirement that there be a principal purpose to avoid the 100 partner rule recognizes that looking through a flow-through entity is not appropriate in all cases, even if the flow-through entity owns no interest other than an interest in the lower-tier partnership, but should be limited to situations in which a principal purpose of the flow-through entity is to avoid the 100 partner limitation.

#### Lack of Actual Trading

The proposed regulations provide that interests in a partnership are not readily tradable on the substantial equivalent of a secondary market if the sum of the percentage interests transferred during the taxable year does not exceed two percent. Several commentators suggested expanding this safe harbor to secondary markets so that partnerships could be assured that some level of trading would not result in public trading. This comment is adopted in the final regulations.

#### Qualifying Income

Several commentators requested guidance on the definition of *qualifying income* and *financial business* for purposes of the qualifying income exception of section 7704. These regulations are intended to address only the definition of public trading and therefore do not provide guidance on the definition of qualifying income. The IRS and Treasury, however, are actively considering guidance on the definition of qualifying income and financial businesses for investment partnerships and other partnerships engaged in various types of securities transactions. The IRS and Treasury invite comments on the scope and form of such guidance.

#### Transitional Relief

The proposed regulations provide that they will be effective for taxable years of a partnership beginning on or after the date final regulations are published. The preamble to the proposed regulations requests comments on whether transitional relief is necessary

for partnerships that qualified for an exclusion under Notice 88-75. Many commentators suggested some form of transitional relief, ranging from 180 days to a permanent grandfather provision.

The final regulations provide that, for partnerships that were actively engaged in an activity before December 4, 1995, the regulations apply for taxable years beginning after December 31, 2005. This ten-year grandfather provision is similar to the grandfather rule provided on the enactment of section 7704. The final regulations provide that this transitional relief expires if the partnership adds a substantial new line of business within the meaning of § 1.7704-2. The transitional relief is not affected by a termination of the partnership under section 708(b)(1)(B). Finally, partnerships subject to transitional relief may continue to rely on Notice 88-75 for guidance.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

**Drafting Information.** The principal author of these regulations is Christopher T. Kelley, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.7704-1 is added to read as follows:

**§ 1.7704-1 Publicly traded partnerships.**

(a) *In general*—(1) *Publicly traded partnership.* A domestic or foreign partnership is a publicly traded partnership for purposes of section 7704(b) and this section if—

(i) Interests in the partnership are traded on an established securities market; or

(ii) Interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

(2) *Partnership interest*—(i) *In general.* For purposes of section 7704(b) and this section, an interest in a partnership includes—

(A) Any interest in the capital or profits of the partnership (including the right to partnership distributions); and

(B) Any financial instrument or contract the value of which is determined in whole or in part by reference to the partnership (including the amount of partnership distributions, the value of partnership assets, or the results of partnership operations).

(ii) *Exception for non-convertible debt.* For purposes of section 7704(b) and this section, an interest in a partnership does not include any financial instrument or contract that—

(A) Is treated as debt for federal tax purposes; and

(B) Is not convertible into or exchangeable for an interest in the capital or profits of the partnership and does not provide for a payment of equivalent value.

(iii) *Exception for tiered entities.* For purposes of section 7704(b) and this section, an interest in a partnership or a corporation (including a regulated investment company as defined in section 851 or a real estate investment trust as defined in section 856) that holds an interest in a partnership (lower-tier partnership) is not considered an interest in the lower-tier partnership.

(3) *Definition of transfer.* For purposes of section 7704(b) and this section, a transfer of an interest in a partnership means a transfer in any form, including a redemption by the partnership or the entering into of a financial instrument or contract described in paragraph (a)(2)(i)(B) of this section.

(b) *Established securities market.* For purposes of section 7704(b) and this section, an established securities market includes—

(1) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f);

(2) A national securities exchange exempt from registration under section 6 of the Securities Exchange Act of 1934

(15 U.S.C. 78f) because of the limited volume of transactions;

(3) A foreign securities exchange that, under the law of the jurisdiction where it is organized, satisfies regulatory requirements that are analogous to the regulatory requirements under the Securities Exchange Act of 1934 described in paragraph (b) (1) or (2) of this section (such as the London International Financial Futures Exchange; the Marche a Terme International de France; the International Stock Exchange of the United Kingdom and the Republic of Ireland, Limited; the Frankfurt Stock Exchange; and the Tokyo Stock Exchange);

(4) A regional or local exchange; and

(5) An interdealer quotation system that regularly disseminates firm buy or sell quotations by identified brokers or dealers by electronic means or otherwise.

(c) *Readily tradable on a secondary market or the substantial equivalent thereof*—(1) *In general.* For purposes of section 7704(b) and this section, interests in a partnership that are not traded on an established securities market (within the meaning of section 7704(b) and paragraph (b) of this section) are readily tradable on a secondary market or the substantial equivalent thereof if, taking into account all of the facts and circumstances, the partners are readily able to buy, sell, or exchange their partnership interests in a manner that is comparable, economically, to trading on an established securities market.

(2) *Secondary market or the substantial equivalent thereof.* For purposes of paragraph (c)(1) of this section, interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof if—

(i) Interests in the partnership are regularly quoted by any person, such as a broker or dealer, making a market in the interests;

(ii) Any person regularly makes available to the public (including customers or subscribers) bid or offer quotes with respect to interests in the partnership and stands ready to effect buy or sell transactions at the quoted prices for itself or on behalf of others;

(iii) The holder of an interest in the partnership has a readily available, regular, and ongoing opportunity to sell or exchange the interest through a public means of obtaining or providing information of offers to buy, sell, or exchange interests in the partnership; or

(iv) Prospective buyers and sellers otherwise have the opportunity to buy, sell, or exchange interests in the partnership in a time frame and with the

regularity and continuity that is comparable to that described in the other provisions of this paragraph (c)(2).

(3) *Secondary market safe harbors.* The fact that a transfer of a partnership interest is not within one or more of the safe harbors described in paragraph (e), (f), (g), (h), or (j) of this section is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

(d) *Involvement of the partnership required.* For purposes of section 7704(b) and this section, interests in a partnership are not traded on an established securities market within the meaning of paragraph (b)(5) of this section and are not readily tradable on a secondary market or the substantial equivalent thereof within the meaning of paragraph (c) of this section (even if interests in the partnership are traded or readily tradable in a manner described in paragraph (b)(5) or (c) of this section) unless—

(1) The partnership participates in the establishment of the market or the inclusion of its interests thereon; or

(2) The partnership recognizes any transfers made on the market by—

(i) Redeeming the transferor partner (in the case of a redemption or repurchase by the partnership); or

(ii) Admitting the transferee as a partner or otherwise recognizing any rights of the transferee, such as a right of the transferee to receive partnership distributions (directly or indirectly) or to acquire an interest in the capital or profits of the partnership.

(e) *Transfers not involving trading*—

(1) *In general.* For purposes of section 7704(b) and this section, the following transfers (private transfers) are disregarded in determining whether interests in a partnership are readily tradable on a secondary market or the substantial equivalent thereof—

(i) Transfers in which the basis of the partnership interest in the hands of the transferee is determined, in whole or in part, by reference to its basis in the hands of the transferor or is determined under section 732;

(ii) Transfers at death, including transfers from an estate or testamentary trust;

(iii) Transfers between members of a family (as defined in section 267(c)(4));

(iv) Transfers involving the issuance of interests by (or on behalf of) the partnership in exchange for cash, property, or services;

(v) Transfers involving distributions from a retirement plan qualified under section 401(a) or an individual retirement account;

(vi) Block transfers (as defined in paragraph (e)(2) of this section);

(vii) Transfers pursuant to a right under a redemption or repurchase agreement (as defined in paragraph (e)(3) of this section) that is exercisable only—

(A) Upon the death, disability, or mental incompetence of the partner; or

(B) Upon the retirement or termination of the performance of services of an individual who actively participated in the management of, or performed services on a full-time basis for, the partnership;

(viii) Transfers pursuant to a closed end redemption plan (as defined in paragraph (e)(4) of this section);

(ix) Transfers by one or more partners of interests representing in the aggregate 50 percent or more of the total interests in partnership capital and profits in one transaction or a series of related transactions; and

(x) Transfers not recognized by the partnership (within the meaning of paragraph (d)(2) of this section).

(2) *Block transfers.* For purposes of paragraph (e)(1)(vi) of this section, a block transfer means the transfer by a partner and any related persons (within the meaning of section 267(b) or 707(b)(1)) in one or more transactions during any 30 calendar day period of partnership interests representing in the aggregate more than 2 percent of the total interests in partnership capital or profits.

(3) *Redemption or repurchase agreement.* For purposes of section 7704(b) and this section, a redemption or repurchase agreement means a plan of redemption or repurchase maintained by a partnership whereby the partners may tender their partnership interests for purchase by the partnership, another partner, or a person related to another partner (within the meaning of section 267(b) or 707(b)(1)).

(4) *Closed end redemption plan.* For purposes of paragraph (e)(1)(viii) of this section, a redemption or repurchase agreement (as defined in paragraph (e)(3) of this section) is a closed end redemption plan only if—

(i) The partnership does not issue any interest after the initial offering (other than the issuance of additional interests prior to August 5, 1988); and

(ii) No partner or person related to any partner (within the meaning of section 267(b) or 707(b)(1)) provides contemporaneous opportunities to acquire interests in similar or related partnerships which represent substantially identical investments.

(f) *Redemption and repurchase agreements.* For purposes of section 7704(b) and this section, the transfer of

an interest in a partnership pursuant to a redemption or repurchase agreement (as defined in paragraph (e)(3) of this section) that is not described in paragraph (e)(1) (vii) or (viii) of this section is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof only if—

(1) The redemption or repurchase agreement provides that the redemption or repurchase cannot occur until at least 60 calendar days after the partner notifies the partnership in writing of the partner's intention to exercise the redemption or repurchase right;

(2) Either—

(i) The redemption or repurchase agreement requires that the redemption or repurchase price not be established until at least 60 calendar days after receipt of such notification by the partnership or the partner; or

(ii) The redemption or repurchase price is established not more than four times during the partnership's taxable year; and

(3) The sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private transfers described in paragraph (e) of this section) does not exceed 10 percent of the total interests in partnership capital or profits.

(g) *Qualified matching services.*—(1) *In general.* For purposes of section 7704(b) and this section, the transfer of an interest in a partnership through a qualified matching service is disregarded in determining whether interests in the partnership are readily tradable on a secondary market or the substantial equivalent thereof.

(2) *Requirements.* A matching service is a qualified matching service only if—

(i) The matching service consists of a computerized or printed listing system that lists customers' bid and/or ask quotes in order to match partners who want to sell their interests in a partnership (the selling partner) with persons who want to buy those interests;

(ii) Matching occurs either by matching the list of interested buyers with the list of interested sellers or through a bid and ask process that allows interested buyers to bid on the listed interest;

(iii) The selling partner cannot enter into a binding agreement to sell the interest until the 15th calendar day after the date information regarding the offering of the interest for sale is made available to potential buyers and such time period is evidenced by contemporaneous records ordinarily

maintained by the operator at a central location;

(iv) The closing of the sale effected by virtue of the matching service does not occur prior to the 45th calendar day after the date information regarding the offering of the interest for sale is made available to potential buyers and such time period is evidenced by contemporaneous records ordinarily maintained by the operator at a central location;

(v) The matching service displays only quotes that do not commit any person to buy or sell a partnership interest at the quoted price (nonfirm price quotes) or quotes that express interest in a partnership interest without an accompanying price (nonbinding indications of interest) and does not display quotes at which any person is committed to buy or sell a partnership interest at the quoted price (firm quotes);

(vi) The selling partner's information is removed from the matching service within 120 calendar days after the date information regarding the offering of the interest for sale is made available to potential buyers and, following any removal (other than removal by reason of a sale of any part of such interest) of the selling partner's information from the matching service, no offer to sell an interest in the partnership is entered into the matching service by the selling partner for at least 60 calendar days; and

(vii) The sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in private transfers described in paragraph (e) of this section) does not exceed 10 percent of the total interests in partnership capital or profits.

(3) *Closing.* For purposes of paragraph (g)(2)(iv) of this section, the closing of a sale occurs no later than the earlier of—

(i) The passage of title to the partnership interest;

(ii) The payment of the purchase price (which does not include the delivery of funds to the operator of the matching service or other closing agent to hold on behalf of the seller pending closing); or

(iii) The date, if any, that the operator of the matching service (or any person related to the operator within the meaning of section 267(b) or 707(b)(1)) loans, advances, or otherwise arranges for funds to be available to the seller in anticipation of the payment of the purchase price.

(4) *Optional features.* A qualified matching service may be sponsored or operated by a partner of the partnership (either formally or informally), the underwriter that handled the issuance

of the partnership interests, or an unrelated third party. In addition, a qualified matching service may offer the following features—

(i) The matching service may provide prior pricing information, including information regarding resales of interests and actual prices paid for interests; a description of the business of the partnership; financial and reporting information from the partnership's financial statements and reports; and information regarding material events involving the partnership, including special distributions, capital distributions, and refinancings or sales of significant portions of partnership assets;

(ii) The operator may assist with the transfer documentation necessary to transfer the partnership interest;

(iii) The operator may receive and deliver funds for completed transactions; and

(iv) The operator's fee may consist of a flat fee for use of the service, a fee or commission based on completed transactions, or any combination thereof.

(h) *Private placements*—(1) *In general.* For purposes of section 7704(b) and this section, except as otherwise provided in paragraph (h)(2) of this section, interests in a partnership are not readily tradable on a secondary market or the substantial equivalent thereof if—

(i) All interests in the partnership were issued in a transaction (or transactions) that was not required to be registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.); and

(ii) The partnership does not have more than 100 partners at any time during the taxable year of the partnership.

(2) *Exception for certain offerings outside of the United States.* Paragraph (h)(1) of this section does not apply to the offering and sale of interests in a partnership that was not required to be registered under the Securities Act of 1933 by reason of Regulation S (17 CFR 230.901 through 230.904) unless the offering and sale of the interests would not have been required to be registered under the Securities Act of 1933 if the interests had been offered and sold within the United States.

(3) *Anti-avoidance rule.* For purposes of determining the number of partners in the partnership under paragraph (h)(1)(ii) of this section, a person (beneficial owner) owning an interest in a partnership, grantor trust, or S corporation (flow-through entity), that owns, directly or through other flow-through entities, an interest in the partnership, is treated as a partner in the partnership only if—

(i) Substantially all of the value of the beneficial owner's interest in the flow-through entity is attributable to the flow-through entity's interest (direct or indirect) in the partnership; and

(ii) A principal purpose of the use of the tiered arrangement is to permit the partnership to satisfy the 100-partner limitation in paragraph (h)(1)(ii) of this section.

(i) [Reserved].

(j) *Lack of actual trading*—(1) *General rule.* For purposes of section 7704(b) and this section, interests in a partnership are not readily tradable on a secondary market or the substantial equivalent thereof if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in transfers described in paragraph (e), (f), or (g) of this section) does not exceed 2 percent of the total interests in partnership capital or profits.

(2) *Examples.* The following examples illustrate the rules of this paragraph (j):

*Example 1. Calculation of percentage interest transferred.* (i) ABC, a calendar year limited partnership formed in 1996, has 9,000 units of limited partnership interests outstanding at all times during 1997, representing in the aggregate 95 percent of the total interests in capital and profits of ABC. The remaining 5 percent is held by the general partner.

(ii) During 1997, the following transactions occur with respect to the units of ABC's limited partnership interests—

(A) 800 units are sold through the use of a qualified matching service that meets the requirements of paragraph (g) of this section;

(B) 50 units are sold through the use of a matching service that does not meet the requirements of paragraph (g) of this section; and

(C) 500 units are transferred as a result of private transfers described in paragraph (e) of this section.

(iii) The private transfers of 500 units and the sale of 800 units through a qualified matching service are disregarded under paragraph (j)(1) of this section for purposes of applying the 2 percent rule. As a result, the total percentage interests in partnership capital and profits transferred for purposes of the 2 percent rule is .528 percent, determined by—

(A) Dividing the number of units sold through a matching service that did not meet the requirements of paragraph (g) of this section (50) by the total number of outstanding limited partnership units (9,000); and

(B) Multiplying the result by the percentage of total interests represented by limited partnership units (95 percent)  $([50/9,000] \times .95 = .528 \text{ percent})$ .

*Example 2. Application of the 2 percent rule.* (i) ABC operates a service consisting of computerized video display screens on which subscribers view and publish nonfirm price quotes that do not commit any person to buy or sell a partnership interest and

unpriced indications of interest in a partnership interest without an accompanying price. The ABC service does not provide firm quotes at which any person (including the operator of the service) is committed to buy or sell a partnership interest. The service may provide prior pricing information, including information regarding resales of interests and actual prices paid for interests; transactional volume information; and information on special or capital distributions by a partnership. The operator's fee may consist of a flat fee for use of the service; a fee based on completed transactions, including, for example, the number of nonfirm quotes or unpriced indications of interest entered by users of the service; or any combination thereof.

(ii) The ABC service is not an established securities market for purposes of section 7704(b) and this section. The service is not an interdealer quotation system as defined in paragraph (b)(5) of this section because it does not disseminate firm buy or sell quotations. Therefore, partnerships whose interests are listed and transferred on the ABC service are not publicly traded for purposes of section 7704(b) and this section as a result of such listing or transfers if the sum of the percentage interests in partnership capital or profits transferred during the taxable year of the partnership (other than in transfers described in paragraph (e), (f), or (g) of this section) does not exceed 2 percent of the total interests in partnership capital or profits. In addition, assuming the ABC service complies with the necessary requirements, the service may qualify as a matching service described in paragraph (g) of this section.

(k) *Percentage interests in partnership capital or profits*—(1) *Interests considered*—(i) *General rule.* Except as otherwise provided in this paragraph

(k), for purposes of this section, the total interests in partnership capital or profits are determined by reference to all outstanding interests in the partnership.

(ii) *Exceptions*—(A) *General partner with greater than 10 percent interest.* If the general partners and any person related to the general partners (within the meaning of section 267(b) or 707(b)(1)) own, in the aggregate, more than 10 percent of the outstanding interests in partnership capital or profits at any one time during the taxable year of the partnership, the total interests in partnership capital or profits are determined without reference to the interests owned by such persons.

(B) *Derivative interests.* Any partnership interests described in paragraph (a)(2)(i)(B) of this section are taken into account for purposes of determining the total interests in partnership capital or profits only if and to the extent that the partnership satisfies paragraph (d) (1) or (2) of this section.

(2) *Monthly determination.* For purposes of this section, except in the

case of block transfers (as defined in paragraph (e)(2) of this section), the percentage interests in partnership capital or profits represented by partnership interests that are transferred during a taxable year of the partnership is equal to the sum of the percentage interests transferred for each calendar month during the taxable year of the partnership in which a transfer of a partnership interest occurs (other than a private transfer as described in paragraph (e) of this section). The percentage interests in capital or profits of interests transferred during a calendar month is determined by reference to the partnership interests outstanding during that month.

(3) *Monthly conventions.* For purposes of paragraph (k)(2) of this section, a partnership may use any reasonable convention in determining the interests outstanding for a month, provided the convention is consistently used by the partnership from month to month during a taxable year and from year to year. Reasonable conventions include, but are not limited to, a determination by reference to the interests outstanding at the beginning of the month, on the 15th day of the month, or at the end of the month.

(4) *Block transfers.* For purposes of paragraph (e)(2) of this section (defining block transfers), the partnership must determine the percentage interests in capital or profits for each transfer of an interest during the 30 calendar day period by reference to the partnership interests outstanding immediately prior to such transfer.

(5) *Example.* The following example illustrates the rules of this paragraph (k):

*Example. Conventions.* (i) ABC limited partnership, a calendar year partnership formed in 1996, has 1,000 units of limited partnership interests outstanding on January 1, 1997, representing in the aggregate 95 percent of the total interests in capital and profits of ABC. The remaining 5 percent is held by the general partner.

(ii) The following transfers take place during 1997—

(A) On January 15, 10 units of limited partnership interests are sold in a transaction that is not a private transfer;

(B) On July 10, 1,000 additional units of limited partnership interests are issued by the partnership (the general partner's percentage interest is unchanged); and

(C) On July 20, 15 units of limited partnership interests are sold in a transaction that is not a private transfer.

(iii) For purposes of determining the sum of the percentage interests in partnership capital or profits transferred, ABC chooses to use the end of the month convention. The percentage interests in partnership capital and profits transferred during January is .95 percent, determined by dividing the number of transferred units (10) by the total number

of limited partnership units (1,000) and multiplying the result by the percentage of total interests represented by limited partnership units ( $(10/1,000) \times .95$ ). The percentage interests in partnership capital and profits transferred during July is .7125 percent ( $(15/2,000) \times .95$ ). ABC is not required to make determinations for the other months during the year because no transfers of partnership interests occurred during such months. ABC may qualify for the 2 percent rule for its 1997 taxable year because less than 2 percent (.95 percent + .7125 percent = 1.6625 percent) of its total interests in partnership capital and profits was transferred during that year.

(iv) If ABC had chosen to use the beginning of the month convention, the interests in capital or profits sold during July would have been 1.425 percent ( $(15/1,000) \times .95$ ) and ABC would not have satisfied the 2 percent rule for its 1997 taxable year because 2.375 percent (.95 + 1.425) of ABC's interests in partnership capital and profits was transferred during that year.

(1) *Effective date—(1) In general.* Except as provided in paragraph (l)(2) of this section, this section applies to taxable years of a partnership beginning after December 31, 1995.

(2) *Transition period.* For partnerships that were actively engaged in an activity before December 4, 1995, this section applies to taxable years beginning after December 31, 2005, unless the partnership adds a substantial new line of business after December 4, 1995, in which case this section applies to taxable years beginning on or after the addition of the new line of business. Partnerships that qualify for this transition period may continue to rely on the provisions of Notice 88-75 (1988-2 C.B. 386) (see § 601.601(d)(2) of this chapter) for guidance regarding the definition of readily tradable on a secondary market or the substantial equivalent thereof for purposes of section 7704(b).

(3) *Substantial new line of business.* For purposes of paragraph (1)(2) of this section—

(i) Substantial is defined in § 1.7704-2(c); and

(ii) A new line of business is defined in § 1.7704-2(d), except that the applicable date is "December 4, 1995" instead of "December 17, 1987".

(4) *Termination under section 708(b)(1)(B).* The termination of a partnership under section 708(b)(1)(B) due to the sale or exchange of 50 percent or more of the total interests in partnership capital and profits is disregarded in determining whether a partnership qualifies for the transition

period provided in paragraph (l)(2) of this section.

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

Approved: November 21, 1995.

Leslie Samuels,

*Assistant Secretary of the Treasury.*

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## ENVIRONMENTAL PROTECTION AGENCY

### 40 CFR Part 70

[AD-FRL-5339-1]

### Title V Clean Air Act Final Interim Approval of Operating Permits Program; State of Delaware

**AGENCY:** U.S. Environmental Protection Agency (EPA).

**ACTION:** Final interim approval.

**SUMMARY:** EPA is promulgating interim approval of the operating permits program submitted by the State of Delaware. This program was submitted by the State for the purpose of complying with federal requirements for an approvable program to issue operating permits to all major stationary sources, and to certain other sources.

**EFFECTIVE DATE:** January 3, 1996.

**ADDRESSES:** Copies of the State of Delaware's submittal and other supporting information used in developing the final interim approval are available for inspection during normal business hours at the following location: Air, Radiation, and Toxics Division, U.S. Environmental Protection Agency, Region III, 841 Chestnut Building, Philadelphia, PA 19107.

**FOR FURTHER INFORMATION CONTACT:** Robin M. Moran, (3AT23), Air, Radiation and Toxics Division, U.S. Environmental Protection Agency, Region III, 841 Chestnut Building, Philadelphia, PA 19107, (215) 597-3023.

#### SUPPLEMENTARY INFORMATION:

##### I. Background

##### A. Introduction

Title V of the 1990 Clean Air Act Amendments (section 501-507 of the Clean Air Act (CAA)), and implementing regulations at 40 Code of Federal Regulations (CFR) part 70 require that states seeking to administer a Title V operating permits program develop and submit a program to EPA by November 15, 1993, and that EPA act to approve or disapprove each program